

Ten Most Common Violations Found in DRE Audits

The real estate industry has moved into a new millennium. New things pop up every day changing the way we do business. Yet, certain things have not changed - the most common violations found in DRE Audits. In this regard, the top ten common violations are listed below. The purpose of this article is to call your attention to these common deficiencies and to provide you with procedures that you can follow to ensure compliance with these laws and regulations.

B & P Code Section 10148 - Retention of Records

Business and Professions Code Section 10148(a) states that a real estate broker shall retain for three years copies of all listings, deposit slips, canceled checks, trust records, and other documents executed by him or her or obtained by him or her in connection with any transactions for which a real estate license is required. This section requires that, after notice, the books, accounts, and records shall be made available for examination, inspection, and copying by the commissioner or his or her designated representative during regular business hours; and shall, upon the appearance of sufficient cause, be subject to audit without further notice, except that the audit shall not be harassing in nature.

A broker who fails to keep transaction files, canceled checks or front and back of check copies, deposit slips or other records prepared or obtained for a period of three years may be cited for violation of this section. Some brokers cited for violation of this section have simply failed to provide records after reasonable attempts by the Department to examine them. Other brokers cited have lost control of or destroyed records that should have been maintained. Formal legal action can result from a broker's failure to provide records. You should review the record retention policies for your office to make sure you are in compliance with this code section.

Regulation 2731 - Use of False or Fictitious Name

Commissioner's Regulation 2731 states that a licensee shall not use a fictitious name in the conduct of any activity for which a license is required under the Real Estate Law unless the licensee is the holder of a license bearing the fictitious name. Brokers should periodically check their license status with the Department to be sure that their license bears the fictitious name(s) they are using. Many brokers cited for violation of this regulation believed that having the dba registered with the county was sufficient to allow them to use it in their real estate business. Other brokers who are cited for this violation state that they had the fictitious name on their license at one time but may have had their license lapse for a brief period of time and failed to add the dba back on to their license.

Regulation 2831 - Trust Fund Records To Be Maintained

This regulation requires the broker to maintain, in columnar form, a record of all trust funds received and deposited by the broker. At a minimum, the following information must be indicated in columnar form in chronological order: date funds were received; name of payee or payor; amount received; date of deposit; amount paid out; check number and date; and the daily running balance of the trust account. If any of these columns are not present, then there is a violation of Regulation 2831. The accurate use of DRE form RE 4522 fully complies with this regulation.

When we cite this regulation, most of the time it is for one or more of the following reasons:

- The broker did not maintain any trust fund records.
- If trust fund records were maintained, they were either not in columnar form or a column (noted above) was missing. We have seen many brokers utilize a standard checkbook as trust fund records. These records do not comply with Regulation 2831.
- In some instances, columnar records were maintained by a licensee but he/she was still cited because the items posted were not accurate, e.g., when posting a check, it was the wrong amount; or, for a deposit, "the amount" was wrong and/or "the date of deposit" was the wrong date.
- A broker maintaining columnar records can still be cited if a daily running balance is not maintained or is inaccurate. Brokers must always keep a daily running balance of the aggregate amount of trust funds in their bank accounts.

(For trust funds not deposited into a trust account, the columnar record should show the date trust funds were received, the form of the trust funds, amount received, description of the property, identity of the person to whom funds were forwarded, and date of disposition. The accurate use of DRE form RE 4524 fully complies with this part of the regulation.)

It should be noted that records maintained under an automated data processing system in accordance with generally accepted accounting principles should be in compliance as long as they contain the elements previously noted and are maintained in a format that will readily enable tracing and reconciliation in accordance with Reg. 2831.2.

Regulation 2831.1 - Separate Record for Each Beneficiary or Transaction

This regulation requires the broker to maintain, in columnar form, a separate record of trust funds for each beneficiary or transaction accounting for all funds which have been deposited into a trust account. This record identifies which beneficiary has funds in the trust account. This record must indicate the following in chronological order and in columnar form: date of deposit, amount of deposit, name of payee or payor, check number, date and amount, and running balance of the separate record after each transaction on any date.

This regulation is cited mostly due to one or more of the following reasons:

- The broker did not maintain separate records for each beneficiary.
- Separate records were maintained, but the broker was cited because information was missing.

- Separate records were maintained, but the broker was cited because the items posted were not accurate, e.g., when posting a check, it was the wrong amount; or, for a deposit, "the amount" was wrong and/or "the date of deposit" was the wrong date.
- Separate records were maintained, but a daily running balance for each record was not maintained or it was not accurate. Brokers must always keep a daily balance for each separate record.

It should be noted that records maintained under an automated data processing system in accordance with generally accepted accounting principles should be in compliance as long as they contain the elements previously noted and are maintained in a format that will readily enable tracing and reconciliation in accordance with Reg. 2831.2.

Regulation 2831.2 - Trust Account Reconciliation

Regulation 2831.2 requires that the total of all Separate Beneficiary or Transaction Records maintained pursuant to Regulation 2831.1 be reconciled with the balance of the Record of All Trust Funds Received and Paid Out required by Regulation 2831, at least once a month except when the bank account did not have any activities. The requirement is that the accounting records be reconciled to each other. This is not only a legal requirement. This is also part of a sound internal control for trust fund handling.

In order for this procedure to have a reliable result, the Record of All Trust Funds Received and Paid Out must be reconciled first with the bank account statements as of a certain cut-off date. This procedure is commonly known as bank reconciliation and is performed to determine the accuracy of the records. A cut-off date is the calendar date (usually end of the month) when no transaction or activity thereafter is considered. This process is completed once all adjustments and corrections of any reconciling items have been made to the ending balance on each record to arrive at an adjusted cash balance. In other words, the balance of the record of all trust funds received and paid out has to equal the adjusted cash balance.

The next step is to compare and reconcile the total of all beneficiary or transaction records with the adjusted cash balance as of the cut-off date of the bank reconciliation. The main objective of this procedure is to determine, based on the records, whether all trust funds held on behalf of others are on deposit in the corresponding trust account. Another purpose of this procedure is to ascertain that there is no unidentified overage or broker's funds in excess of \$200 in the trust account. Any discrepancy must be corrected accordingly. The broker is required to maintain a record of the trust account reconciliation showing the name of the bank account and number, date of the reconciliation, account number or name of the principals, beneficiaries or transactions and the amount of trust funds held by the broker for each of the principals, beneficiaries or transactions. Failure to comply with this Regulation could result in substantial loss of trust funds and disciplinary action against the broker by the Department.

Regulation 2832.1 - Trust Fund Handling for Multiple Beneficiaries (Trust Fund Shortage)

Regulation 2832.1 requires the real estate broker to obtain written consent from every owner of the trust funds in the bank account prior to each disbursement if the disbursement will reduce the balance of the funds in the bank account to an amount less than the existing trust fund liability of the broker to all owners of the funds. A trust fund shortage therefore exists when the following conditions are present:

1. The balance of the bank account is less than the total trust fund liability of the broker to all owners of the funds; and
2. There is no written authorization from all owners of the trust funds allowing this.

The most obvious reason for a trust fund shortage is the intentional misuse (conversion) of trust funds. However, simple record keeping errors that remain undetected could result in trust fund shortages and an actual loss of funds. Failure to record a disbursement, or understating the amount of a check disbursed, or overstating the amount of a deposit on the beneficiary ledger/record will cause the beneficiary ledger to show a balance that is larger than the true amount owed to the individual beneficiary. This overstated balance on the ledger is more likely to be paid and, consequently, the beneficiary will be paid more than what is due. The end result is a trust fund shortage.

Performing the proper trust account reconciliation pursuant to Regulation 2831.2 should enable the broker to detect such causes of a trust fund shortage.

B & P Code Section 10145/ Regulation 2832 - Trust Fund Handling

Section 10145 and Commissioner's Regulation 2832 together require that a broker place funds accepted on behalf of another into the hands of the owner of the funds, into a neutral escrow depository or into a trust fund account in the name of the broker, or in a fictitious name if the broker is the holder of a license bearing such fictitious name, as trustee at a bank or other financial institution not later than three business days following receipt of the funds by the broker or by the broker's salesperson. Two of the most common problems related to this regulation are:

1. A broker's failure to designate accounts receiving trust funds as trust fund accounts in the name of the broker or broker's dba as trustee; and
2. Failure to deposit trust funds received by a broker or broker's employee into a trust fund account within three business days of receipt.

Other common violations of these sections relate to a broker's use of an improper interest-bearing account {Regulation 2832(b)}, a broker's failure to place checks received from an

offeror into a neutral escrow depository or trust fund account in a timely manner following acceptance of an offer {Regulations 2832(c & d)} and failure of a broker acting as an escrow holder in a transaction in which the broker is performing acts for which a real estate license is required to place trust funds received as required not later than the next business day following receipt of the funds {Regulation 2832(e)}.

Regulation 2834 - Trust Account Withdrawals

Commissioner's Regulation 2834(a) states that withdrawals may be made from a trust fund account of an individual broker only upon the signature of the broker or one or more of the following persons if specifically authorized in writing by the broker:

1. A salesperson licensed to the broker.
2. A person licensed as a broker who has entered into a written agreement pursuant to Section 2726 with the broker.
3. An unlicensed employee of the broker with fidelity bond coverage at least equal to the maximum amount of trust funds to which the employee has access at any time.

Regulation 2834(b) also states that withdrawals may be made from a trust fund account of a corporate broker only upon the signature of:

1. An officer through whom the corporation is licensed pursuant to Section 10158 or 10211 of the Code; or
2. One of the persons enumerated in paragraph (1), (2) or (3) of Regulation 2834(a), provided that specific authorization in writing is given by the officer through whom the corporation is licensed and the officer is an authorized signatory of the trust fund account.

Regulation 2834(c) states that a broker or broker-officer is responsible or liable for the handling of trust funds regardless of the existence of any authorization given regarding signature authority.

The most common violations found in audits related to Regulation 2834 are:

1. The failure of the broker or designated officer to be a signatory on the trust account (this may indicate a supervision problem).

2. Presence of an unlicensed signatory on the trust account who does not have fidelity bond coverage.
3. Fidelity bond coverage inadequate in amount and/or has a deductible.
4. The failure of the broker or designated officer to give specific written authorization permitting a salesperson, broker or unlicensed person to sign on the trust account.

B & P Code Section 10145/ Regulation 2835 - Commingling

A broker shall not commingle with his or her own money or property the money or property of others which he or she receives and holds. Common causes of this violation are the deposit of trust funds received into the broker's general business account or maintenance of over \$200 in broker funds in a trust account holding trust funds.

A common example of this violation is when a broker deposits credit report fees and/or appraisal fees received into his or her general bank account instead of a trust account when he or she has not yet paid the bill. Often, the reason for this violation is that the broker does not maintain a trust account or the broker was not aware that credit report fees and appraisal fees are trust funds.

B & P Code Section 10240 - Written Disclosure Statement

Another often-cited violation is Section 10240 of the code which requires brokers to provide a borrower with a mortgage loan disclosure statement within three business days after receipt of a completed loan application or before the borrower becomes obligated on the note, whichever is earlier. Real estate brokers often fail to provide the Mortgage Loan Disclosure Statement (Borrower) or, in a federally regulated residential mortgage loan transaction, fail to comply with Section 10240(c). Other brokers fail to maintain completed copies for their files.

In conclusion, as you race to keep up with the ever-changing opportunities that present themselves in business today, take a moment to stop and ensure that your business is operating in compliance with these and other important real estate laws.

For further information, you may wish to review the [Broker Compliance Evaluation Manual](#).